ORIGINAL

BARAFF, KOERNER, OLENDER & HOCHBERG, P. C.

ATTORNEYS AT LAW
5335 WISCONSIN AVENUE, N. W., SUITE 300
WASHINGTON, D. C. 20015-2003
(202) 686-3200

DOCKET FILE COPY ORIGINAL

B. JAY BARAFF
ROBERT L. OLENDER
JAMES A. KOERNER
PHILIP R. HOCHBERG
MARK J. PALCHICK
JAMES E. MEYERS

OF COUNSEL
ROBERT BENNETT LUBIC

FAX: (202) 686-8282

September 14, 1993

Mr. William Caton
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: Comments of Pegasus Cable Television
Cost of Service
MM Docket 93-215

Dear Mr. Caton:

Enclosed please find an original and four copies of Comments in the above-referenced matter. Should you have any questions regarding this matter, please contact the undersigned counsel.

Very truly yours,

Mark J. Palchick
Counsel for
Pegasus Cable Television

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

In the Matter of	
Sections of the Cable Television Consumer Protection and Competition Act of 1992	MM Docket 93-215
Rate Regulation	
Cost of Service	

REPLY COMMENTS OF PEGASUS CABLE TELEVISION

Pegasus Cable Television L.P. ("Pegasus"), by its attorneys, herewith submits its limited Reply Comments in the above-referenced notice of proposed rulemaking. Pegasus has focused its Reply on the design and implementation of a simplified approach to cost-of-service for low-density cable systems.

Pegasus Cable Television is a small multiple system operator operating low-density systems in rural New England. It currently provides cable television service to 17,500 subscribers in New England and has participated in earlier stages of the FCC's rate regulation proceedings.

I. Pegasus Supports The Need For A Streamlined Alternative For Low-Density Systems.

Pegasus supports Prime Cable's view that the Commission's adopted benchmark and price cap approach does not afford low-density cable operators the opportunity to receive a reasonable

profit and imposes administrative and financial burdens. Prime Cable recognized that systems with low densities operate under special conditions that other cable systems do not share. It costs the same amount to build, power and maintain a mile of cable plant, regardless of the number of homes passed by that plant mile. Therefore, since there are less homes passed, the cost of serving each subscriber is higher than the cost per subscriber in areas of average density. As a result, in rural areas, these largely fixed costs per mile must be spread over fewer subscribers resulting in relatively higher costs per subscriber.

The benchmark rate determination does not take into consideration the higher per subscriber costs that exist in systems with low densities.[1] Accordingly, many small systems, such as Pegasus, could be required to roll rates back. However, many rural cable systems cannot implement such rate rollbacks without triggering violations of their loan covenants. Indeed, benchmark compliance could cause many rural system operators to default on their debt service obligations. Faced with such dire consequences, rural operators are in effect forced into making a cost-of-service showing.

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[1]In the Arthur Anderson Study submitted by Prime Cable, it was pointed out that low density systems were not adequately represented in the FCC's sample.

II. Cost-Of-Service Showing Is Too Burdensome For Low-Density System Operator Under The Traditional Formula Proposed By The Commission.

For multiple system operators with small systems, a cost-of-service showing will impose unreasonable administrative and financial burdens. As Prime Cable argued, the cost of preparing the forms associated with regulation, complying with signal carriage rules, implementing new customer service standards and adjusting facilities to meet the technical and administrative needs will impose undue hardship on these small operators. This will result in higher operating costs. Therefore, the amount of required revenue per subscriber will have to be even higher to meet the expenses associated with a full cost-of-service showing. Low density systems will have to pay for this increased cost of regulation from a subscriber base that already has higher than average per subscriber costs.

Although regulatory relief has been afforded to those cable systems which fit within the definition of a "small system"[2], many rural operators do not fall within the Commission's definition of a "small system", since they exceed the threshold. As a result, rural operators will be forced to reallocate their resources away from operational functions to meet the increased demands of their regulatory compliance.

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[2] Under the Notice of Proposed Rulemaking, MM Docket 93-215, FCC 93-353 (released July 16, 1993) ("Notice"), a "small system" is defined as those systems which have subscriberships of 1,000 or fewer subscribers. Notice, para. 76.

III. The Commission Should Establish A Streamlined Cost-Of-Service Process Which Could Be Applied As A "Safe Harbor".

In the Notice, the Commission requested comments on whether a "streamlined alternative" could be adopted to ease the burdens that traditional rate-of-return regulation can create, but that still meets the Commission's regulatory goals.[3] One alternative the Commission has suggested as a streamlined alternative could "permit cable operators to document key cost factors, financial characteristics, or other combination of factors that could be said to justify existing rates."[4]

Pegasus agrees with Prime Cable that there is a need for a streamlined alternative to the cost-of-service showing for low density systems and proposes the implementation of a "Safe Harbor" formula as a reasonable alternative to a full cost-of-service showing. In using this "Safe Harbor" formula, cable systems with rates at or below the formula-derived standard for cost-of-service would not be required to make a full-blown cost-of-service showing. Those cable operators who exceed the formula-derived standard could then elect to make a comprehensive cost-of-service showing justifying rates which exceed the conceived standard.

A. "Safe Harbor" Formula

The formula proposed constitutes a refinement of the

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[3] Notice, para. 70.

[4] Notice, para. 72.

formula the Commission described in the Notice. The formula proposed in the Notice consists of a cable company's revenue requirement equaling the expenses of providing service together with its return on investment, or $R = E + (V-d)r$.[5]

Pegasus suggests the use of a modified version of this formula:

$$R = E + ((V - d)r) / (1 - t)$$

Where:

R = Revenue requirement

E = Expenses (all expenses except income taxes)

V = Value of the rate base

d = Accumulated depreciation

r = Rate of return requirement

t = Income tax rate

By expanding upon certain elements of this formula and establishing certain standard values, an easily implemented "Safe Harbor" formula can be defined.

Factors E, V and d can be defined in more detail as follows:

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[5] R is the revenue requirement; E is expenses including operating expenses, maintenance expenses, depreciation and taxes; V is the value of the rate base including plant in service and working capital; d is accumulated depreciation; and r is the rate-of-return consisting of a weighted average of long-term debt, preferred stock, and common stock. (Notice, para. 20 n.18)

1. **Expenses (E)**

The valuation of expenses (E) would consist of:

$E = (C \times S) + (T \times M) + [(V - d) / Lr]$

Where:

C = customer service expenses, programming expenses, general and administrative costs per subscriber

S = number of subscribers to system

T = technical service costs per mile of plant

M = number of plant miles

Lr= the lesser of the remaining useful life of plant or the franchise term

These costs taken together should comprise the total value of expenses a cable operator can include in the formula. C and T would constitute total operating expenses. The value attributed to C would be sensitive to the number of subscribers.

2. **Value of the Rate base (V)**

Furthermore, the value of the rate base should be the following:

$V = (P \times M) + (H \times Ch)$

Where:

P = plant cost per mile

H = headend cost per channel

Ch = number of channels used for regulated services

3. **Depreciation (d)**

Depreciation could be calculated based on the following:

$$d = (V / L) \times (L - Lr)$$

Where:

L = the original life of plant

The values for C, T, P, H, and L could be established by the Commission and the values for S, M, Lr and Ch would be input by the system operator. Under the valuation for depreciation, Pegasus proposes that the Commission determine a standard value for the original life of plant. The resultant R factor would be divided by the Channel Factor (line 106E of Form 393) to determine the revenue requirement per channel. If the system's rate per channel is no greater than such amount, a cost-of-service showing would not be required.

The Safe Harbor procedure is also useful in systems that have undergone technological upgrades. Any upgrade would naturally extend the useful life of the system's plant. Therefore, Lr would increase and (L-Lr) would decrease. The accumulated depreciation would therefore decrease and the net rate base (V-d) would increase.

Although every cable operator may not comfortably fit within the parameters of this formula, those entities that do not fit would still be able to make a full-blown cost-of-service showing. The purpose of the proposed formula is to provide a manageable alternative to the Commission's benchmark that will ensure that the majority of cable operators enjoy a reasonable profit, while still avoiding cumbersome, costly and extensive cost-of-service showings. Any cable entity that does not fit within the rubric of the formula can then elect to justify its higher rates with a cost-of-service showing. However, generally speaking, the "Safe Harbor" formula should assist many operators and provide a less burdensome alternative where the benchmarks do not provide a reasonable profit as required by the 1992 Cable Act.

IV. Conclusion

Unfortunately for cable operators with low-density systems, the benchmark/price cap approach does not take under consideration the additional financial liability that is inherent in the operation of these systems. Because the Commission's definition of a "small system" does not include those cable systems located in areas of low-density, these small operators will be forced to make full-blown cost-of-service showings. The "Safe Harbor" formula set forth above will assist the Commission in fairly assessing the costs associated with

low-density service, while still remaining consistent with the congressional mandate set forth in the 1992 Cable Act.

Respectfully submitted,

Pegasus Cable Television

By: _____

Mark J. Palchick
Baraff, Koerner, Olender & Hochberg, P.C.
5335 Wisconsin Avenue, N.W., Suite 300
Washington, D.C. 20015
(202) 686-3200

September 14, 1993

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CERTIFICATE OF SERVICE

I, Marianne C. Lynch, certify that I have this 14th day of September, 1993, sent by regular United States mail, postage prepaid, a copy of the foregoing "**REPLY COMMENTS OF PEGASUS CABLE TELEVISION**" to:

Ron Parver, Esq., Chief*
Cable Television Branch
Federal Communications Commission
1919 M Street, NW, Room 416
Stop Code: 1800E4
Washington, D.C. 20554

Chairman James H. Quello*
Federal Communications Commission
1919 M Street, NW, Room 314
Stop Code: 0106
Washington, D.C. 20554

Commissioner Andrew C. Barrett*
Federal Communications Commission
1919 M Street, NW, Room 844
Stop Code: 0103
Washington, D.C. 20554

Commissioner Ervin S. Duggan*
Federal Communications Commission
1919 M Street, NW, Room 832
Stop Code: 0104
Washington, D.C. 20554

Ms. Alexandra Wilson*
Federal Communications Commission
1919 M Street, NW, Room 314
Stop Code: 1800
Washington, D.C. 20554

Mr. William H. Johnson, Deputy Chief*
Mass Media Bureau
Federal Communications Commission
1919 M Street, NW, Room 314
Stop Code:1800
Washington, D.C. 20554

By: Marianne C. Lynch
Marianne C. Lynch

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* Hand delivered